STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
CHELTONCORT CO.	:	DETERMINATION
for Revision of a Determination or for Refund of Tax on Gains Derived from Certain Real Property Transfers under Article 31-B of the Tax Law.	:	

Petitioner, Cheltoncort Co., 2051 Flatbush Avenue, Brooklyn, New York 11234, filed a petition for revision of a determination or for refund of tax on gains derived from certain real property transfers under Article 31-B of the Tax Law (File No. 804790).

A hearing was held before Joseph W. Pinto, Jr., Administrative Law Judge, at the offices of the Division of Tax Appeals, Two World Trade Center, New York, New York, on March 20, 1990 at 1:15 P.M., with all briefs submitted by August 6, 1990. Petitioner appeared by Joseph Gaier, Esq. The Division of Taxation appeared by William F. Collins, Esq. (Paul A. Lefebvre, Esq., of counsel).

ISSUE

Whether the Division of Taxation properly assessed gains tax on the "economic gain" received by petitioner in consideration of transferring certain real property to a cooperative corporation.

FINDINGS OF FACT

Petitioner, Cheltoncort Co., was the owner of certain real property located at 360 West 21st Street, New York, New York. On the property was situated a building which was five stories high and had a fullcellar. Within the building, at the time of its conversion, were 51 residential apartments and seven stores located on the ground floor.

Cheltoncort Co. acquired the property on June 29, 1984 and subsequently converted the building to cooperative form. An offering plan, dated November 21, 1985, was accepted for

filing by the Department of Law on December 20, 1985. The offering plan was declared effective on March 18, 1987, and on June 18, 1987, title to the property was transferred from Cheltoncort Co. to Cheltoncort Owners Corp. The consideration for the transfer of the property included cash, a purchase money mortgage and unsold shares. At the heart of the dispute herein, is a possible fourth item of consideration, a master lease on the commercial space occupying the ground floor of the building. The Division of Taxation contends that the lease had value and therefore represented an "economic gain" to petitioner, while petitioner argues that the commercial space was merely reserved by the sponsor and was never actually transferred to the cooperative corporation, hence, yielding no "economic gain" to the sponsor.

The Offering Plan states, on page 1, item "2", under the title "Special Risks", as follows:

> "2. The building contains seven (7) stores. On the Closing Date, the Stores will be leased to the Sponsor or an assignee of the Sponsor for a period of twenty-five (25) years with an option to renew for twenty-four (24) years for a total period of forty-nine (49) years. The rent for such stores will be $55,000.00 per year for the first two (2) years and thereafter increased or decreased as certain operating costs of the Apartment Corporation increase or decrease (see 'Management Agreement, Contracts and Leases'). The Sponsor intends to sublease the stores and make a profit on the rental. The Apartment Corporation will not receive the benefit of any increased rental value for the stores because increases in rent payments are based upon increases in certain operating costs of the Apartment Corporation. The lease does not give the Apartment Corporation control over the future use of the leased space. However, the lease provides that the stores must be used for a lawful purpose and prohibits the maintenance of any nuisance. Sponsor shall have the right to assign the lease without the consent of the Apartment Corporation and shall also have the right to mortgage its leasehold estate without consent. Lessee shall have no personal liability for any of the terms, covenants and conditions of the lease and in the event of lessee's default, the Apartment Corporation's remedy shall be limited to lessee's leasehold estate."

The offering plan set forth each of the seven stores as they were currently leased including the address of each store, the lessee, type of business, length of lease, and current rent. As set forth in Finding of Fact "3", above, the annual rent under the master lease for the first two years was to be $55,000.00 a year. Thereafter, commencing with the third year of the lease, the lessee was to pay rent to be set annually on the first day of the month next succeeding the anniversary of the closing, equal to 17½% of the increase in certain "operating expenses" of the Apartment Corporation. For purposes of the lease, the term "operating expenses" was meant to include:

"[a] labor, but shall not include additional expenses attributable to increases in services or personnel;

[b] mortgage interest, but not in excess of the amount of interest payable at the prevailing rate, at the time the wraparound mortgage is refinanced, provided that the principal sum of said new mortgage is not in excess of the unpaid principal balance of the wraparound mortgage;

[c] real estate taxes over that paid for the fiscal tax year in which the closing occurs;

[d] fuel;

[e] water and sewer charges; (unless the stores install separate meters for water) and

[f] fire insurance premiums." (See Offering Plan, page 64.)

In determining the purchase price for the offering, the 51 apartments were allocated 13,245 shares, while no shares were allocated to the commercial space. Consideration received under the offering, was the cash received through the sale of the shares in the cooperative corporation for the 51 apartments plus the mortgage of $1,800,000,000.00. No cash consideration was attributed to and none was received for the commercial space.

At the closing of title, simultaneously with the execution of the deed from the sponsor to the cooperative corporation, the cooperative corporation executed and delivered to the sponsor a lease for the commercial space. It is noted that the cooperative owners corporation needed to have title to the entire real property including the commercial space before it could execute a lease of part of the premises as landlord/lessor.

At the same time the lease was executed, the parties executed a New York City transfer tax return for the leased premises, which was required for the recording of the lease, in which the sponsor and the cooperative, both under oath, acknowledged that no consideration was paid for the leasehold. At the time, for the purpose of determining New York State transfer tax (.4% of the gross sales price) on the transfer of title from the sponsor to the cooperative corporation, a tax was paid based upon the cash consideration received for the apartments of $3,086,671.00 plus the mortgage of $1,800,000.00 for a total consideration of $4,886,671.00. The same consideration was the basis for the filing of the payment of the New York City transfer tax (2%

of the gross consideration). Both taxing authorities accepted the consideration as stated and the payment of the tax based thereon. The same consideration, $4,886,671.00, was submitted to the Division of Taxation for gains tax purposes as well.

However, in determining the gains tax due, the Division of Taxation assumed that the lease for the commercial space was additional consideration received by the sponsor, even though there was no identifying consideration set forth in the offering plan and in spite of the fact that the commercial space was never offered for sale as part of the conversion.[1]

The Division of Taxation essentially took the difference between the rent required to be paid to the cooperative corporation under the lease and the rent received from the sub-tenants of the seven stores as they were in existence at the time the gains tax assessment was submitted for review, projected those rents for the full term of 49 years and reduced that sum to its present value. The Division of Taxation determined the "economic gain" to be $387,300.38 and increased the gains tax due thereon by 10% of that figure, or $38,730.00. Petitioner has paid $25,812.83 of this amount and filed a claim for refund in that amount dated September 3, 1987. By letter dated January 28, 1988, the Division denied the claim for refund in full.

CONCLUSIONS OF LAW

A. Tax Law § 1441 imposes a tax on gains derived from the transfer of real property within the State. Further, Tax Law § 1440.7 provides that:

> "Transfer of an interest in real property shall include the creation of a leasehold or sublease only where (i) the sum of the term of the lease or sublease and any options for renewal exceeds forty-nine years, (ii) substantial capital improvements are or may be made by or for the benefit of the lessee or sublessee, and (iii) the lease or sublease is for substantially all of the premises constituting the real property."

Since these three elements are not present in the instant action, the lease is not a transfer of real property and not subject to the gains tax. (See also, 20 NYCRR 590.5[a].) However, the Division argues that the value of the lease, and petitioner concedes that it does have value, should

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[1]Neither the lease nor any of the attendant documents were ever submitted into evidence herein.

be taxed under Tax Law § 1440.1(a) which provides that "consideration" means "the price paid or required to be paid for real property or any interest therein...." The same section provides that consideration also includes "any price paid or required to be paid...or any other thing of value...." (See also, 20 NYCRR 590.8.)

B. Petitioner makes much of the fact that the Division conceded that if the transaction in issue had been conducted under a condominium format, there would have been incurred no tax for the so-called "economic gain". Petitioner cites Matter of Normandy Associates (Tax Appeals Tribunal, May 23, 1989) in support of its contention that both condominiums and cooperatives should be treated equally under the Tax Law. Petitioner cites language from the Normandy Associates decision which indicates that the Tribunal believed the Legislature intended that transfers pursuant to a cooperative plan be treated exactly like transfers pursuant to a condominium plan, i.e., as transfers directly by the realty transferor to the unit purchasers (see, Normandy Associates, Tax Appeals Tribunal, supra at 7-8). The question in Normandy, however, was at what point in the conversion process a taxable event occurred for gains tax purposes. It is in this context that the Tribunal decided that the transfer to the cooperative corporation was merely a use of the cooperative corporation as a conduit which allowed the transformation of the real property into shares allocated to the various units. Cheltoncort Co. argues that the concept of equal treatment of cooperative and condominium conversions mentioned in the Normandy case must be applied to all facets of the conversion process including the leasing of commercial space in the building.

Petitioner contends that it, as the sponsor in the instant matter, reserved the commercial space for its own use by requiring a master lease to be executed simultaneously with the granting of a deed to the cooperative corporation whereby it became the lessee of the commercial space. Petitioner further contends that this reservation of the commercial space pursuant to the master lease is identical to the reservation of a condominium unit by a sponsor under a condominium conversion plan. To accept petitioner's thesis, one must assume that there are no basic differences between condominium and cooperative ownership. However, this

is not the case. A condominium has been defined as a single real property parcel with all the unit owners having a right in common to use the "common elements" of the parcel and with separate ownership confined to individual units which are serially designated. (Kaufman and Broad Homes of Long Island, Inc. v. Albertson, 73 Misc 2d 84, 341 NYS2d 321.) Cooperative ownership, on the other hand, is a form of joint control over property in which each resident has an interest in the entity which owns the building and a lease or occupancy agreement entitling him to occupy a particular apartment within the building. It is a vehicle for the common ownership of property, allowing the occupants, who are the stockholders of the cooperative, to own, manage, and operate residential apartments without anyone profiting therefrom. A cooperative plan involves elements of ownership, as well as stock and leasehold rights. (See, 19 NY Jur 2d, Condominiums, § 47.)

Although petitioner correctly points out that the Division does not ascribe economic gain to a condominium unit reserved by the sponsor for its own use, even in the case where the sponsor leases said condominium for commercial purposes, it fails to point out the relationships which exist in such a situation both under a condominium and cooperative structure. In the case of a condominium format, it is the sponsor which becomes the lessor of the property and which is ultimately responsible for the common charges charged to its reserved unit. The sponsor may not exempt itself from liability for its common charges by waiver of the use or enjoyment of any of the common elements or by abandonment of the unit. (See Real Property Law § 339-x.) In the instant situation, the sponsor is not the lessor but the lessee of the commercial space in the building. It is the cooperative corporation which is the lessor and which is ultimately responsible for the commercial spaces' fair share of the common elements and expenses incurred for the running of the property, i.e., heat, hot water, labor, real estate taxes, fuel, water and sewer, fire insurance, and mortgage interest. As clearly set forth in the offering plan, "the lessee shall have no personal liability for any of the terms, covenants and conditions of the lease and in the event of the lessee's default, the apartment corporation's remedy shall be limited to lessee's leasehold estate." Therefore, any unpaid expenses by the lessee are the ultimate

responsibility of the cooperative corporation i.e., the unit purchasers. Hence, the very real distinction between a condominium and cooperative format becomes apparent. Although it was appropriate under the circumstances in Normandy Associates to view the cooperative corporation as a mere conduit, the legal entity can not be set aside when determining the rights, obligations and responsibilities of parties to the master lease herein.

In the simplest of terms, the realty was transferred to the cooperative corporation and a portion of the premises was leased back to the sponsor under concededly advantageous terms. It cannot be denied that something of value was received by the sponsor and that that value constituted part of the consideration paid by the cooperative corporation for the transfer of the building. After all, the cooperative corporation gave up all profits to be made from the leasing of the commercial space and accepted the ultimate risks involved with regard to the terms, convenents and conditions of the lease.

C. The petition of Cheltoncort Co. is denied and the Division's denial of the claim for refund of real property transfer gains is sustained.

DATED: Troy, New York

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ADMINISTRATIVE LAW JUDGE